CHAPTER II

CONSUMER PROTECTION AND PUBLIC PURPOSE PROGRAMS:

The Role of The Local Distribution Utility

The move to retail electric competition will require each state to redefine the role of its local utilities. For over 100 years local electric utilities have had a monopoly on the generation, distribution, and transmission of electricity. Now policymakers must decide what portion of this vertically-integrated industry will remain subject to monopoly regulation and what portion should be open to competition. The distribution function will remain a monopoly in all states which have adopted electric restructuring legislation to date. This will mean that the local poles and wires used to deliver electricity will not be duplicated. In some states, the distribution function will continue to include billing, metering and customer service functions, but in other states these services will also be opened to competition. The consumer protection implications of billing and metering competition will be explored further in Chapter III.

Long distance transportation—or transmission--of electricity through high voltage transmission wires will continue to be regulated under the federal jurisdiction of the Federal Energy Regulatory Commission (FERC). This transmission system is used primarily for wholesale transactions between today's utilities but is now being opened to private transactions by generation plant owners to assure nondiscriminatory access under FERC-controlled policies and prices. This division between the state-controlled distribution system and the federally-controlled transmission system generally conforms with the historical jurisdiction of states over the retail sale of electricity and the authority of the federal government (FERC) over wholesale transactions.[14] Although not required to do so, some regions are forming an Independent System Operator (ISO) to govern access to the transmission system and to establish price and access rules which accommodate competitive generation suppliers. This is still an evolving issue in many states.

In general, states are deciding how to regulate the three major functions of the electric industry:

Generation: The generation and sale of electricity

Transmission: The long distance transportation of electricity between distribution utilities and generating sources

Distribution: The local delivery system, including poles and wires

The changing role for utility companies to a more limited distribution function has important implications for consumer protection and public purpose programs. States will need to analyze the comprehensive regulatory scheme that is applicable to today's public utilities and decide which policies and regulations should continue to apply to the distribution portion of the business; which should be changed or added to respond to the new industry structure; and which should be created to apply to the competitive generation portion of the business. With respect to distribution companies, the most important policies and issues that should be addressed include

- obligation to serve;
- default service;
- reliability of service and service quality;
- Universal Service programs;
- credit and collection policies; and
- privacy of customer information.

The remainder of this Chapter will address these issues.

Obligation to Serve

The duty of the distribution utility will change from an *obligation to serve* to *access* to the electric grid on a nondiscriminatory basis. Under this approach, the distribution utility will continue to provide line extensions and assure connection to the local distribution system. Indeed, the distribution utility will probably retain its right to use eminent domain power to assure the proper design and operation of the delivery system. This continued delegation of state authority is often viewed as justification for continued utility participation in the implementation of state policies, such as encouraging energy efficiency, and supporting renewable resources and universal service programs. What is clear from this altered mission is that state regulators may no longer count on the local utility alone to assure that all households have access to reasonably priced electricity service.

Default Service

Every state that has considered the implications of a move to retail competition has determined that a Default Service option (also referred to as a "Standard Offer" or "Basic Service") must be provided to customers who do not choose a competitive supplier for generation services. In other words, customers will be assured a continuous source of electricity even if they do not choose a new supplier. In addition to those customers who "choose not to choose," there are other customers who must be assured access to electricity, such as

- those refused service by a retail supplier;

- customers whose supplier's electric service contract is canceled for any reason;

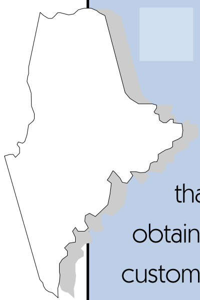
- customers who need supply during a transition to a new dwelling or who become new customers and have not yet chosen a supplier; and finally,

- those customers whose supplier stops doing business or whose license is revoked by a state agency.

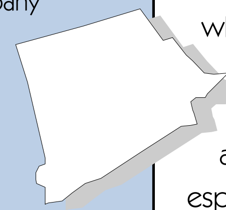
It is important to recognize that the Default Service option exists to serve two different groups of customers: (1) customers who choose not to select a competitive supplier; and (2) customers who are unable to select or retain service from a competing supplier. The purpose of Default Service for customers who have options, but do not exercise them, is different from the purpose of safety net service for those who are unable to obtain competitive electricity services with reasonable terms. With regard to the choose not-to-choose group, states will have to decide who will provide the generation portion of the service. This decision will have a significant impact on market power (that is, whether the incumbent will be awarded these customers) and customer acceptance of change. If there is too little change, customers may not see the point of entering the competitive market. If there is too much change (i.e., the adoption of a volatile market-based price as a substitute for an historically stable rate structure), customers may resist and threaten the political acceptance of the move to competition. As in all other aspects of restructuring, the market price and number of competitors will have a great deal to do with customer reaction to, and interest in participating in, the competitive market.

The purpose of ensuring a safety net for customers who cannot obtain generation service at a reasonable price is related to universal service policy goals and the need to assure access to the electricity system for all customers. Whether technically low-income or not, these customers have a basic need for continuous electric service, and society has an interest in preventing unnecessary risks to household health and safety that could be caused by significant interruptions in the supply of electricity. The alternative is physical disconnection of service. Nothing would do more to create adverse reaction to competition than a significant increase in customer disconnections as a result of difficulties working with competitive suppliers or the inability of customers to obtain service from suppliers. Even if most customers need Default Service for only short periods of time, some kind of Default Service will *always* be needed and should not be confused with what may be a short-term need for Default Service for customers who choose not-to-choose.

Even though Default Service serves multiple purposes, it is possible to devise one regulated service to respond to different needs. Alternatively, a state could authorize two different services, one for a transition period which is available to current customers who choose not-to-choose, and another which is permanently available to any customer in transition or who enters the



Both **Maine** and **Rhode Island** restructuring legislation mandate that the distribution company obtain Default Service for its customers via an open market bid supervised by the public utilities commission.



Several **Ohio** legislators have proposed that generation services for all customers be bid based on regional retail marketing areas. Customers could then opt out by choosing their own competitive supplier.

competitive market and seeks to return to regulated rates. Massachusetts has pursued this approach. Utilities in the state will offer a Standard Offer rate to existing customers for a seven-year period, which will be regulated based on rates in effect prior to the onset of retail competition. Safety Net service, a permanent service with more volatile market-based rates, will be available to any customer who enters the competitive market and then seeks to return to regulated rates.

The most controversial policy issue associated with Default Service has been its impact on the existing utility company, particularly with respect to customers who do not choose in the early years of retail competition. If customers can, by doing nothing, remain customers of their current utility, then the distribution utility (and its retail sales affiliate) has gained a tremendous competitive advantage. Competitors will have an uphill battle to penetrate this almost guaranteed market, which may, in turn, discourage them from incurring marketing expenses associated with gaining residential and small commercial customers, especially in relatively small markets. In most jurisdictions, incumbent utilities have argued strenuously for the right to provide electricity to these customers and to be clearly identified as their electricity source. Potential competitors have just as strenuously objected, pointing out that this approach "gives" a significant share of the emerging market to incumbents and will prevent, or at least delay, the development of a competitive market.

States have identified four ways to provide Default Service:

Create a Bid Process

This process allows one or more retail suppliers to provide Default Service through a competitive bidding process. The winning bidder (or perhaps two bidders offering different rate designs) obtains the right to serve customers for a set period of time. The state requires the distribution company to offer electricity service pursuant to the bid conditions and procedures or establishes new regional entities to conduct bids for such services, thereby entirely eliminating the distribution utility. In either case, customers see a change in their electricity supplier. The distribution company or regional entity is required to act in a fiduciary capacity on behalf of its customers in conducting the bid process so that their customers get the best deal possible, given the conditions of the stated offer. Under this approach, the state regulatory commission oversees the bid process and mandates key terms for Default Service: rate design, billing options, term of service, etc. This option has the advantage of providing a regulated service option with the least amount of change to customers but which builds upon the competitive aspects of the new electricity market.

Require Distribution Utilities to Provide Default Service at Market-Based Rates

Some states have chosen to anoint the distribution company as the provider of Default Service and to mandate a market price, that is, the price any customer would pay for access to short-term supplies of electricity. This scenario is often accompanied by a requirement that utilities divest their generation facilities or sell their power output into a pool and then obtain market priced electricity for default customers. Because short term market rates are often volatile, this option is often accompanied by legislative requirements to cap rates at current levels or even decrease rates overall.

Require Distribution Utilities to Provide Default Service Under a Rate Cap or Rate Decrease

Another variation on Default Service requires distribution companies to continue supplying electricity to its customers using its own generation facilities or energy obtained from the wholesale market. This option is also typically accompanied by a requirement that the utility provide either a rate cap or rate decrease during the transition years (the years in which stranded costs are being recovered). This option allows customers to do nothing and continue to receive electricity from their current utility.

In **California** distribution utilities must sell all their power into the power pool (Power Exchange) and then obtain electricity for Default Service customers at the prevailing market price for a transitional period. This service is priced at market rates, but the customer's total bill reflects a 10% rate decrease in the early years, as mandated by the state's electric restructuring legislation.

Ballot and Spread by Random Assignment

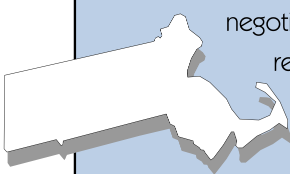
Prior to the implementation of customer choice, a state could mandate that customers choose an electricity supplier via a ballot system and randomly assign those who do not select a specific supplier to one of several suppliers who have registered and indicated a willingness to accept such customers. The commission would have the authority to mandate certain basic minimum terms which suppliers would have to meet as a condition of providing this service. This approach has the advantage of forcing the development of a competitive market, but customers may not be ready to accept this mandated change in their electricity supplier.

In fact, this approach was used in some states following implementation of competition in the interstate long distance telephone market. Customers complained and resisted automatic assignment to a supplier, referring to it as a form of “regulatory slamming” and triggering association with the particularly egregious practice of changing customers’ telephone providers without permission.

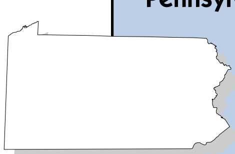
Assuring Reliability of Service

Distribution utilities will remain responsible for most aspects of power quality because of their retained ownership of the distribution system, that is, the poles and wires that deliver electricity to each customer’s home and place of business.[15] Therefore, distribution utilities will remain responsible for service reliability (outages, their frequency and duration), installation of service (service drops, as well as line extensions in previously unserved areas), service disconnection, complaint resolution, change-orders, and billing and collection.

Electric restructuring legislation passed in several states has reaffirmed the duty of distribution utilities to maintain service quality and reliability in the transition to a new industry structure and has linked that obligation to the use of Performance-Based Ratemaking (PBR) in setting rates for distribution services. PBR typically retains strict control over basic service rates for core customers by either freezing prices or revenues or establishing a formula that restricts utilities’ ability to raise prices or revenues for these customer groups. Utilities are usually given significant pricing



Larger utilities in **Massachusetts** have negotiated settlements which require distribution companies to continue to provide a Standard Offer based on current rates with a 10-15% decrease for customers who do not choose. In addition, these utilities must also provide a Safety Net Service to customers who enter the competitive market and then seek to return to the distribution company for a short period of time. This service must be provided at short term market rates. Recently-enacted electric restructuring legislation in Massachusetts has adopted this approach.



Pennsylvania’s electric restructuring law does not mandate divestiture and requires the local utilities to continue to provide generation services subject to various rate caps during the period in which stranded costs are being collected. The PUC may choose an alternative method for Default Service after the transition period.

and marketing flexibility within limits set by either the rate freeze or the rate formula. In return, utilities assume more risk. Shareholders may retain earnings if the utility is efficient or if earnings increase, but must also assume the risk of loss if earnings drop during the term of the plan. Most of these alternative rate plans are multi-year in nature.

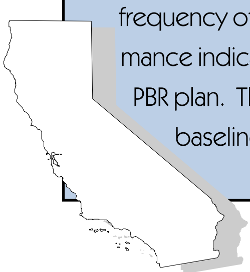
Utility commissions have struggled with how to assure adequate customer service and reliability through PBR. Commissions initially reasoned that they would rely on their existing rules and investigatory authority to monitor and respond to any deterioration in service quality or reliability. Many commissions dealing with deteriorating service quality in the telephone industry have found this approach to be insufficient.[16] More recent regulatory plans for both telephone and electric/gas utilities contain a specific customer service and reliability index that monitors selected attributes of service quality and establishes penalties in the form of customer rebates or earnings reductions if performance deteriorates during the term of the plan.[17]

Universal Service Programs

A thorny issue in every state is how to address the impacts of a competitive electricity market on vulnerable customers. Some customers are vulnerable because of their inability to afford utility services or because they are unable to read and comprehend their rights and responsibilities in a competitive market. Most states fund universal service programs through utility rates, either directly or indirectly, which are designed to assist low-income, elderly, or disabled customers with affordable electric service. These programs typically include

- shut-off or disconnection moratoria;
- flexible payment arrangements;
- ratemaking policies concerning how utilities are "made whole" for bad debt and customer service expenses;

Both the **California** and **Pennsylvania** utility commissions have initiated rulemakings that mandate reporting requirements for their distribution utilities which monitor service reliability and other attributes of customer service. These proposed rules typically require distribution utilities to report key indices of reliability, such as minutes of outage per customer and frequency of customer outages. The California PUC will continue to include these performance indicators in the distribution utilities' Service Quality Index included in its PBR plan. The indices include financial penalties for failure to meet historical baseline performance standards.



- requirements for budget billing and bill payment counseling;
- bill payment assistance programs, rate discounts, percentage of income payment plans, and arrearage forgiveness when customers make regular payments; and
- targeted energy efficiency and weatherization programs.

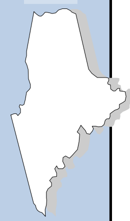
Direct costs associated with targeted discounts and energy management services are relatively easy to identify, but the indirect costs or benefits of certain programs are not as easily identified. Utilities have argued that these programs should not be funded through rates in a competitive environment. Of course, competitive suppliers will have no obligation to comply with these traditional public purpose programs without specific regulatory directives. Distribution companies, although regulated, will have a much narrower role. Policymakers have legitimately asked whether electricity should be treated like food or gasoline—where the government's role to assist those without sufficient resources is handled through the tax system. Most commissions and state legislatures that have taken action in this area have announced their support for continuation of programs and policies that address low-income customers and others with special needs. Legislation adopted in some states not only mandates the continuation of current programs, but allows for expansion or development of new programs by the public utilities commission.

State policymakers are confronting inadequate funding of traditional financial assistance programs for basic needs,[18] and a lack of certainty about the future price of electricity, particularly for low-income customers who may be faced with few or no supplier options. Bill assistance and other programs have been created via utility regulation, modest to be sure in some states, for vulnerable customers facing unaffordable electric or gas bills. Proponents of funding such obligations by means of the state's general tax system argue that utilities are not social welfare organizations and that it is more equitable to fund assistance programs through the tax structure based on a household's income and ability to pay. Those who support funding these programs via utility rates argue that the cost of these programs is already included in rates, that the creation of a new tax-supported energy assistance program is unlikely to occur in the near future, and that a small per-kilowatt hour charge is a relatively small price to pay for universal service programs when industrial customers stand to reap significant benefits through lower prices and increased service options. [19]

The design and funding of these programs will no doubt vary among the states. In Maine, each utility has designed different programs to respond to local concerns within the statutory expenditure guideline of .5% of jurisdictional revenues. The Maine PUC has initiated a rulemaking to determine whether the programs should be operated on a statewide or distribution utility-basis and whether existing programs, which are different at each utility, should follow a uniform approach.[20] The California Public Utility Commission has appointed a Low-Income Governing Board to recommend a statewide administrative structure for low-income programs funded through distribution utility rates.[21] The Pennsylvania PUC has ruled that existing utilities should maintain control and implementation of their low-income programs,[22] and has addressed the exact program design and funding level in each utility's restructuring plan. To date, the Commission has substantially increased the funding and eligibility for these programs.[23]

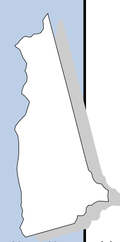
The role of competitive suppliers in funding and delivering universal service programs has been explored in some states, but no state has yet designed a system in which suppliers fund program benefits to low-income customers. However, the Pennsylvania PUC has ordered that bill payment assistance program credits, provided to qualified low-income customers, be "portable." That is, they must be applied in a pro-rata manner to both the distribution and the generation portions of the bill.[24] This will assure that low-income customers enter the competitive market with their bill credits (based on their total electric bill) intact.

Selected Universal Service Programs

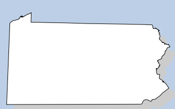


Maine: Distribution utilities must continue to fund low-income assistance programs up to .5% of jurisdictional revenues.

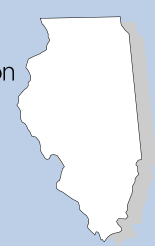
California: The existing 15% discount and access to no-cost weatherization programs for low-income customers will continue, funded by a Public Goods Charge applicable to all customers through their distribution companies.



New Hampshire: Based on the universal service directives in its electric restructuring legislation, the N.H. PUC approved a new low-income assistance program to be funded by distribution companies at a rate of 3 mills per kWh.



Pennsylvania: Electric restructuring legislation mandates, at a minimum, continuation of current programs and policies and requires such programs to be funded through a non-bypassable charge on customers. In the context of individual restructuring plans, the PUC has expanded both energy efficiency and bill payment assistance programs.



Illinois: Recent legislation authorizes a new $76 million low-income program to be funded by distribution utility ratepayers.

Credit and Collection Policies

Most states will continue to regulate the credit and collection practices of distribution utilities, much as they do today. These regulations typically include bill content and format requirements, credit and collection procedures, limitations on the disconnection of at-risk customers (particularly during extreme weather conditions), right to payment arrangements, and reconnection policies. Electric restructuring legislation in several states (Pennsylvania, Massachusetts, and Connecticut) has imposed some or all existing credit and collection rules on all competitive suppliers as well. Other states are creating separate rules of a less comprehensive nature. These issues will be explored in Chapter III of this *Blueprint*. However, with respect to distribution utilities, there are at least two issues that should be addressed in this chapter: physical disconnection of service and allocation of partial payments.

Disconnection of Service

In a competitive market, sellers usually do not have collection devices that prohibit non-paying customers from obtaining the same product from alternate sellers. Most state restructuring laws to date prohibit competitive suppliers from using the threat of physical disconnection at their customers' meters to collect unregulated charges. Of course, suppliers must be able to discontinue their services to nonpaying customers, but this can be accomplished by notice to customers (*Notice of Contract Cancellation*) and to the distribution company without physical disconnection of customers from the grid. If the distribution company fails to obtain specific instructions from its customers, the customer whose contract is canceled by a supplier will be provided with Default Service, which should be subject to actual disconnection according to commission-approved procedures. Competitive suppliers will be able to use standard collection options available to any competitive business, many of which are subject to state and federal consumer protection laws, discussed further in Chapter III. These options include contacting customers and attempting to directly collect unpaid bills, using debt collection agencies, Small Claims Court, and, in more serious cases, filing a civil complaint in a court of general jurisdiction. Suppliers will also be able to report customer credit histories to credit reporting agencies and make use of this information in determining credit terms for applicants.

Allocation of Partial Payments

Closely related to the discussion of service disconnection is the issue of allocating partial payments. If a customer pays only a portion of a total bill issued by a distribution company under contract with the customer's supplier, a rule must be established to determine how to allocate the partial payment between the regulated and non-regulated services. Because the distribution and transmission charges are regulated and the electricity sales are not, most states have determined that the customer's payment be first allocated to those services subject to disconnection (and for which there is no alternative). This is the same approach typically taken today when a regulated utility bills for non-regulated services, such as the sale or lease of water heaters by a gas utility. In addition, this approach also assures that customer payments will be allocated first to the nonbypassable charge which covers stranded costs included by distribution utilities on customer bills.

Customer Privacy

Consumers today should be able to expect that their utility billing and payment records are confidential. There is no federal law, however, that compels privacy, and in many states, there is no statute that specifically protects such records.

Typically, utilities protect this information from disclosure and do not routinely sell or make available customer-oriented research and survey results. In a retail competition scenario, the distribution company will have information concerning its customers that retail suppliers will want to obtain, such as usage profiles and billing and payment history. Allowing access to such information in a competitive market is complicated by the fact that regulated distribution companies will naturally want to give access and preferences to their unregulated retail sales affiliates. This may result in cross-subsidization of the utility's unregulated retail sales efforts by regulated rates for its monopoly distribution function, which, in turn, will hamper the development of a truly competitive market because other competitive suppliers will not have such an advantage. Indeed, because the distribution company and the marketing section of most current public utilities are one organization, this information is routinely exchanged now and, depending on who gets the billing and accounting computer, will continue in the future unless specifically prohibited.

States must strike a balance between the need for fair dealings in the use and access to customer information to enable development of a competitive market and customers' reasonable expectation that personal billing and

Unlike most states, **California** has a statutory policy to protect customer-specific information held by utilities. PUC Code §§585 and 588 establish a general policy that protects customer-specific information held by utilities without written authorization by the customer. Narrow exceptions for commission and law enforcement access to customer-specific billing and payment records require that any exception provide for "...protection of the reasonable expectation of customers of public utilities in the privacy of customer-specific records maintained by that utility." Even in providing for access to such information by law enforcement officials, a customer's usage is protected from access without a court order or subpoena.

payment information will remain private. Suppliers argue that customers benefit if, at least, their usage information is made available, because suppliers can better target their marketing offers based on usage profiles. However, most states have, to date, allowed the release of generic information (not customer-specific) without permission, and generally prohibited the release of customer-specific information without their permission. This requires the distribution company to obtain individual customer permission to release information to its retail sales affiliate or to any other supplier. In addition, states that have addressed this issue have required that distribution utilities provide their customers with historical usage history at least once per year at no cost.

State rules in this regard typically do not change the ability of the distribution utility or retail supplier to communicate customer-specific information to credit reporting agencies or debt collectors for lawful purposes as described in the *Fair Debt Collection Practices Act* or *Fair Credit Reporting Act* both of which are discussed further in Chapter III.